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RUEHDN/AMCONSUL SYDNEY PRIORITY 4856  
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C O N F I D E N T I A L SECTION 01 OF 03 CANBERRA 000754

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SUBJECT: AUSTRALIA'S DEFENSE WHITE PAPER: IS IT AFFORDABLE?

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Classified By: Political Counselor James F. Cole for Reasons 1.4 (b) and (d).

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SUMMARY  
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¶1. (SBU) Australia's 2009 Defense White Paper, released in May 2009, envisions the nation's largest military buildup since World War II. How Australia will pay for this buildup is less clear. Recovery from the recession and a return to fiscal surplus will require budgetary sacrifices. The military faces ingrained problems with poor budgeting, cost overruns, and delays in delivering new equipment exacerbated by efforts to prop up local defense industries. Reaching the White Paper's targets will require sustained political will to address the funding challenges. Hope lies in ADOD's challenging but promising plan to reform the way it does business and generate enough savings to fund the buildup. End summary.

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"AUSTRALIA BULKS UP"  
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¶2. (U) Australia's 2009 Defense White Paper assessed that China's rise and the potential retreat of US regional primacy increases Australia's strategic risks (reftel). To manage this risk, it prescribes an impressive upgrade to the Australian Defense Force's (ADF) capabilities, including replacing 6 Collins Class submarines with 12 long-range submarines, replacing their Anzac frigates with 8 larger frigates, and acquiring up to 100 F-35 Joint Strike Fighters. Following the White Paper's early May release, local newspapers featured headlines like &Australia muscling up& and &White paper orders huge military build-up.&

¶3. (U) The government said its plan was &fully costed and affordable.& The White Paper set out the following funding measures:  
-- 3% real growth in the Defence budget to 2017-18,  
-- 2.2% real growth in the Defence budget from 2018-19 to 2030,  
-- 2.5% fixed indexation to the Defence budget from 2009-10 to 2030 (to offset inflation), and  
-- a Strategic Reform Program (SRP) to identify savings of A\$20 billion over 10 years.

#### FUNDING INCREASE OVERSTATED

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14. (SBU) The White Paper,s 3% real annual growth in the Defense budget continues a funding trajectory established almost a decade earlier under the previous Howard Government, so it does not represent an increase in funding growth. In fact, according to Mark Nixon of Ernst and Young Australia, which does some work for Defence, real annual growth in military spending in the past decade was higher, averaging over 4%.

15. (SBU) Nixon explained that the prior indexation regime, which offsets inflation by indexing the ADOD budget to the non-farm GDP deflator, overcompensated Defence in the years prior to the recession because a mining boom lifted the non-farm GDP deflator far more than the increase in underlying defense costs. At its high, the non-farm GDP deflator reached 7.8%. The White Paper sets the new indexation regime at 2.5%, reducing the chance that the government overshoots in funding growth to ADOD. Thus, Defence will probably see less real funding growth in the coming decade than the previous.

16. (U) Noting that the cost of maintaining military capability exceeds inflation, the GOA-associated think tank ASPI estimated that in order for the ADF to &tread water,8 its budget must grow in real terms by 2.6% per year. Qits budget must grow in real terms by 2.6% per year. Therefore, analysts viewed the White Paper,s decrease from 3% to 2.2% real growth beginning in 2018-19 as wholly inadequate.

17. (U) ASPI also estimated that, assuming that the ADF is able to achieve the SRP,s goal of A\$20 billion in savings,

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the White Paper,s funding plan would provide A\$29 billion in new money (measured in today,s terms). ASPI calculated that achieving a force structure similar to that outlined in the White Paper would cost significantly more, at about A\$37 billion. Furthermore, apart from White Paper initiatives, the May 2009 budget shows ADOD must use A\$15 billion over the next four years to remediate shortfalls from prior initiatives.

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#### PROMISED FUNDING DEFERRED

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18. (U) Military budget analyst Mark Thomson noted that the government probably will not deliver on the 3% real annual growth to 2017-18 stated in the White Paper. The May 2009 budget gives more to the ADF this year but in subsequent years takes away A\$8.8 billion of the money promised by the White Paper. The government gradually returns this money to Defence beginning in 2016-17 so that real growth averages out to the 3% and 2.2% trends stated in the White Paper by the 2020s, but this would not allow 3% real growth by 2017-18.

19. (U) Moreover, Thomson argues that in 2016-17, the government will be trying to achieve a politically important budget surplus following several years of recession-related deficits, and that defense spending historically contracts during Australia,s post-recession recoveries.

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#### FUZZY MATH ON COSTS

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110. (SBU) In addition to overemphasizing the revenue side of the White Paper, Thomson suggested that Defence may have underestimated the future costs of acquiring and servicing new platforms. He pointed out that the Defence Capability Plan released in July shows recurrent problems of cost overruns and delays in equipment acquisition. Thomson also

suggested that Defence may have underestimated future personnel costs, which consumes the largest slice of its budget. The 2009 GOA budget used per capita growth rates for the cost of military and civilian personnel that are respectively 50% and 66% lower than the historical averages.

¶11. (C/NF) In a meeting between US Navy Admiral Benedict and Stephen Gumley, CEO of the Australian Defence Materiel Organisation (DMO), Gumley was unable to explain how the costing for the equipment of the White Paper came about. However, ODC contacts at DMO, which handles the ADF's equipment acquisition and servicing, were confident that the ADF would be able to achieve the White Paper's capability upgrade. To address any financial constraints, they appear prepared to sell Defence real estate and to push back the timeline for acquisitions.

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GETTING MORE WITH LESS  
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¶12. (C/NF) Even if costs remain manageable and Defence receives the supposed 3% real annual growth in Defense spending, about two thirds of the new money for pursuing initiatives under the White Paper must come from A\$20 billion of savings anticipated by the Strategic Reform Program (SRP).

Spread throughout the life of the program, budget analyst Thomson estimates that the SRP is equivalent to saving 7% per year on the ADF's budget, significantly more ambitious than previous spending reform programs. (Note: Australia's military budget for 2009-10 is about A\$26 billion. End note.)

¶13. (C/NF) A senior GOA Treasury official believes that significant savings within ADOD of up to 10% per year, more than that envisioned by the SRP, is feasible and reasonable. He noted that ADOD's budgeting and execution is the worst in the federal government because unlike other departments, the Departments of Treasury, Finance and Prime Minister and Cabinet exercise no oversight on formulating the budget or reviewing effectiveness. Ernst and Young's Mark Nixon, who provides ADOD with some assistance on the SRP, expressed similar sentiments, noting that there is considerable area for improvement in budgeting and efficiency.

¶14. (C/NF) The Treasury official believes that by committing

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the ADF to increased capability and funding it out of the SRP, the GOA will have a stronger base from which to hold Defence's feet to the fire in instituting reforms. Nixon was more pessimistic, noting that there is deep cultural resistance within Defence to change. On August 13, PM Rudd appointed Ian Watt, formerly Secretary of the Department of Finance and Deregulation and known for his competence in handling the economic crisis, as Secretary of Defence. This change may indicate an attempt to establish a Defence leadership capable of carrying out significant financial reforms.

¶15. (C/NF) One area of potential savings regards procurement.

Australian defense analyst Hugh White said that a domestic shipbuilding lobby, particularly in South Australia, encourages major naval acquisitions sourced from expensive domestic shipbuilders. Because the small domestic shipbuilding industry cannot achieve the same economies of scale as that of the U.S., its costs per ship are significantly higher. For example, budget analyst Thomson noted that the ADF's three Hobart class air warfare destroyers cost up to 30 percent more than comparable off-the-shelf vessels available from the U.S. Defence claimed the markup was only 4 percent.

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COMMENT

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¶16. (C/NF) The Defense White Paper is as much a political and diplomatic document as it is a strategic and force structure planning document. To a domestic audience that traditionally views the left-leaning Labor party as weaker on defense, Rudd wants to look tough on security. To the U.S., Australia wants to signal that it is pulling its weight in the alliance. PM Rudd has made clear that it was also a signal to China and to the region that Australia is committed to doing what it can to maintain the strategic balance in East Asia. While the Defence White Paper presents a bold force upgrade, funding is uncertain. Most of the major acquisitions are planned for much later, so the government does not have to focus on footing the bill for the time being. Budget pressures, especially in the wake of the recession, and cost overruns may delay acquisition of new platforms. However, if Defence can find the political will to reform inefficient budgeting and programming, particularly by procuring from the U.S. rather than domestically, it will be able to achieve the needed savings to pursue its ambitious plans.

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